BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
JOHN A. AND)
BARBARA J. VERTULLO)

For Appellants: Stanley A. Solomon
Certified Public Accountant

For Respondent: James W. Hamilton
Acting Chief Counsel

James C. Stewart
Counsel

OPINION

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of John A. and Barbara J. Vertullo against

proposed assessments of additional personal income tax and penalties in the total amounts of $5,663.70 and $7,680.04 for the years I.970 and 1971, respectively.

In 1970 John A. Vertullo (hereafter appellant) and several investors entered into contracts under which appellant agreed to drill more than thirty oil wells for a total price of approximately $507,000. In that year appellant received advance deposits under the contracts in the total amount of $181,500. In I97 I appellant entered into similar contracts and received advance payments in the total amount of $133,500. Appellant was to receive the balance of the contract payments upon completion of the respective wells. However, because appellant was unable to complete a major portion of the wells on schedule, the principal investors rescinded the contracts and demanded the return of their advance pay ments. Consequently, in 1972 and 1973, appellant returned $91,000 and $80,000 of the respective payments which he had received in 1970 and 1971.

For both federal and state income tax purposes, appellant reported the prepaid income from his drilling operations on the accrual basis, utilizing the completed contract method of accounting. Pursuant to an audit of appellant's federal returns for the years 1968 through 1.971, the Internal Revenue Service determined that he did not maintain adequately detailed books and records to utilize the accrual method of accounting. Accordingly, the Internal Revenue Service concluded that all advance payments received by appellant under the drilling contracts constituted income in the year of receipt. The resulting adjustments increased appellant's taxable income for the years 1970 and 1971. In addition, pursuant to section 6653 of the Internal Revenue Code of 1954, a 5 percent negligence penalty was imposed against appellant for the year 1970. Appellant did not protest the federal action.

Subsequently, on the basis of the corresponding federal action, respondent issued proposed assessments of additional tax for the years 1.970 and 1971. Respondent also imposed a 5 percent negligence penalty for the year 1970. Appellant protested respondent's action and this appeal followed.

The primary issue presented by this appeal is the propriety of respondent's action in assessing additional taxes and imposing a negligence penalty solely on the basis of corresponding federal action.

It is well established that a deficiency assessment, as well as a negligence penalty, issued or imposed by respondent on the basis of corresponding federal action is presumed to be correct, and the burden is upon the taxpayer to prove that it is erroneous. (Todd v. McColgan, 89 Cal. App. 2d 509, 514 [201 P. 2d 414]; Appeal of William G., Jr., and Mary D. Wilt, Cal. St. Bd. of Equal., March 8, 1976; Appeal of Robert R. Ramlose, Cal. St. Bd. of Equal., Dec. 7, 1970.) In the instant case, appellant has not presented any evidence to show either that the federal action or that respondent's action was erroneous or improper.

Appellant states that he did not challenge the federal determination concerning the proper year for reporting the payments in question because certain provisions of the Internal Revenue Code allowed him to avoid the adverse tax consequences of the federal action. However, appellant's statement merely explains his reason for not protesting the federal action; it does not provide a basis for overturning the assessments and penalty on appeal. (See Appeal of Donald D. and Virginia C. Smith, Cal. St. Bd. of Equal., Oct. 17, 1973.) Therefore, we must conclude that appellant has not sustained his burden of establishing error in respondent's action.

Appellant also contends that he will be subjected to inequitable treatment if this board sustains respondent's action on appeal. Under federal tax law, appellant argues, a taxpayer who is required to repay a substantial amount of prepaid income subsequent to the year of receipt may avoid the adverse tax consequences of a determination that the income is taxable in the year of receipt. Thus, appellant concludes, an inconsistent and inequitable result will occur if federal law is not applied for state tax purposes.

Prior to 1954, federal tax law required a taxpayer who received funds under a claim of right and without restriction as to their disposition to report such funds as income in the year of receipt, even though the taxpayer subsequently repaid all or a portion of the amount received. (North American Oil Consolidated v. Burnet,

286 U. S. 417 [76 L. Ed. 1197]; Nealy v. Commissioner, 345 U. S. 278 [97 L. Ed. 1007].) If a taxpayer was required to make restoration of prepaid income in a subsequent year, he was entitled to a deduction in the year of repayment. (See North American Oil Consolidated v. Burnet, supra.)

In 1954, Congress enacted section 1341 of the Internal Revenue Code to provide limited tax relief in cases where a taxpayer includes as income in the year of receipt funds which he must repay in 3 later year. (See generally 2 Merten's, Law of Federal Income Taxation § 12. 106a.)

Appellant alleges that by virtue of either the provisions of section 1341 or the net operating loss provisions of section 172 of the Internal Revenue Code of 1954 he has been able to avoid any adverse federal tax consequences which resulted from the determination that the payments in question constituted taxable income in the year of receipt. However, California tax law, as it relates to the issue on appeal, is similar to the federal law as it existed prior to 1954. (See Appeal of Arthur G. and Eugenia Lovering, Cal. St. Bd. of Equal., April 21, 1966) Although a substantial portion of California tax law is based upon its federal counterpart, the Revenue and Taxation Code contains no provisions comparable to section 1341. or section 172. Thus, we view appellant's argument as a plea to this board to apply federal tax law to a set of circumstances with respect to which the California Legislature has chosen not to follow the federal statutes. Such a course of action would be beyond the authority of this board. Federal revenue provisions which have no counterpart in California law may not be applied in determining California income tax liability. (Appeal of Ralph D. and Lena C. Vaughn, Cal. St. Bd. of Equal., Oct. 17, 1973.) Therefore, we have no alternative but to sustain respondent's action in this matter,

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

Appeal of John A. and Barbara J. Vertullo

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of John A. and Barbara J. Vertullo against proposed assessments of additional personal income tax and penalties in the total amounts of $5,663.70 and $7,680.04 for the years 1970 and 1971, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 26th day of July 1.976, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____ Member

_____ Member

ATTEST: _____, Executive Secretary